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SUBJECT: SOUTH AFRICA ECONOMIC NEWSLETTER December 2 2005
ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- 3rd Quarter Growth Slows, Economy Still Strong;
- Manufacturing Activity Slows in November;
- Monthly Current Account Deficit Widens;
- Inflation Less than Expected;
- Possible Weakening of Rand in 2006;
- October Credit Demand Slows;
- Business Confidence High but Stable;
- SA Government Will Publish Official Poverty Measure;
- Mutual Funds to Offer Accounts to Low-Income Market; and
- Recent Research Shows Poverty has Fallen Past Two Years;

End Summary.

3RD QUARTER GROWTH SLOWS, ECONOMY STILL STRONG

¶2. South Africa's economic growth slowed sharply in the third quarter of 2005, but this was mainly due to upward revisions to previous data. With November's release of Gross Domestic Product (GDP), Statistics SA (Stats SA) included revisions of the past three years, which showed the economy was larger than previously thought. Gross domestic product (GDP) grew by 4.2% on a seasonally adjusted and annualized basis in the third quarter, down from 5.4% in the second quarter. A Reuters poll of economists had forecast that GDP would slow to 4.4%. Manufacturing, retail trade, finance, transport and construction were the main sources of third quarter growth fueled by strong domestic spending. The mining sector, contributing 6.4% of GDP, declined by 0.7% its first contraction since the fourth quarter 2004. Stats SA's revisions to GDP showed that the economy expanded by 4.5% in 2004 and 3.0% in 2003, substantially higher than earlier official estimates of 3.7% and 2.8%, respectively. Stats SA revised GDP upwards using new surveys and data. Nominal 2004 GDP increased 0.9% to R1,387 billion ($215 billion, using 2004's average exchange rate at 6.45 rands per dollar). Source: Investec, GDP Update; Reuters, November 29.

MANUFACTURING ACTIVITY SLOWS IN NOVEMBER

¶3. The Purchasing Managers' Index (PMI) slowed considerably in November, reaching 50 and indicating that continued growth in the manufacturing sector would not happen. November was the fourth consecutive month the PMI has fallen and the lowest level reached in the past two years. In October, the PMI was 54.1. All the components of the PMI index fell in November, but the sharpest drop was in the employment index, which dropped 8.4 points to 45.0. Business activity and new sales orders declined substantially as well. The PMI index has been above 50 since the end of October 2003, when it was 47.7 and near the end of a period of contraction in the manufacturing sector. The PMI price index continued to increase in November, rising to 68.6 from 66.7 in October. Forty-five percent of survey respondents anticipated improved conditions near-term, while 16% expected worsening conditions. Source: Business Day, December 1, 2005.

MONTHLY CURRENT ACCOUNT DEFICIT WIDENS

¶4. According to monthly South African Revenue Service statistics, the trade deficit widened to R5.5 billion. Exports fell 11% to R3.3 billion ($510 million), mainly due to a decline in exports for vehicles, aircraft and vessels, and mineral products. This is the third consecutive month in which the trade deficit has widened unexpectedly, and over the past 12 months South Africa has posted a deficit nine times. Although the monthly figures are volatile, a widening current account deficit is expected for 2005. A 4.2% deficit as a percent of GDP is expected by the end of 2005, compared to 2004's 3.2% of GDP. Exports were weaker even though the rand depreciated during October. The rand averaged R6.58 against the

dollar in October, and R6.36 in September. Imports declined as well, falling 4.5% in October. The main reason for the decline in imports was the fall in the oil price from $70 a barrel to about $50, resulting in a decline in the value of mineral product imports of more than R2 billion ($310) during the month. Source: Business Day, December 1.

INFLATION LESS THAN EXPECTED

¶5. October's producer and consumer inflation continued to increase less than expectations, showing little second round impacts of higher oil prices. Consumer prices excluding mortgage costs (CPIX) increased 4.4% compared to market expectations of 4.6%, and producer prices rose by 4.2% with market expectations at 4.5%. Consumer and producer prices showed a small monthly increase of 0.1%, with October's consumer prices rising due to higher transport costs, and producer prices increasing as a result of higher agricultural and petroleum prices with a moderation in electricity prices. In October, consumer prices (CPI) rose by 4.0% compared to September's 4.4%, while producer prices rose in October and September by 4.2% and 4.6%, respectively. Most analysts expect that interest rates will remain unchanged, given that oil prices have moderated and inflationary pressures seem to be concentrated in the transport and petroleum-using sectors. Source: Standard Bank, CPI Alert, November 23; Investec, PPI Update, November 24.

POSSIBLE WEAKENING OF RAND IN 2006

¶6. Even with strong capital inflows, a continuing current account deficit above 3% will continue to weaken the rand in 2006, according to Azar Jammine, the Chief Economist at the financial consultant firm Econometrix. Jammine believes the rand could reach R8 per dollar by the end of 2006 due to South Africa's increasing current account

deficit. The Department of Trade and Industry (DTI) and the Economist Intelligence Unit (EIU) took different views about the future direction of the rand. EIU expects the rand to depreciate in 2006 like Jammine, under pressure from falling prices for metals such as gold and platinum. DTI has forecasted a much stronger rand due to faster economic growth and the country's macroeconomic and fiscal policies. South Africa's current account deficit posted 3.4% of GDP in the second quarter of 2005 compared with 3.8% in the first quarter, despite a relatively strong rand. However, the shortfall in the current account has largely been offset by healthy inflows in the capital account. So far in 2005, the rand has lost about 13% of its value against the dollar. Source: Business Report, November 28.

OCTOBER CREDIT DEMAND SLOWS

¶7. Demand for credit by the private sector was below expectations at 19.5% (y/y) in October, compared to September's rise of 22.3%. October's broadly defined M3 measure of money supply grew by 16.4%, in line with forecasts, after increasing by 16.9% in September. The Reuters consensus poll forecast showed that private sector credit demand, which is driving a consumer spending boom, was likely to rise by 21.3% y/y. Annual growth in M3, pointing to inflation pressures building in the economy, was expected to show an annual growth rate of 16.4% during October. Source: Reuters, November 29.

BUSINESS CONFIDENCE HIGH BUT STABLE

¶8. For most of 2005, business confidence has remained close to the 24-year high of 88, which was attained in the fourth quarter 2004. The business confidence index, which is compiled by the University of Stellenbosch and sponsored by Rand Merchant Bank, fell slightly to 85 in the fourth quarter 2005, compared to 82 and 86 during the second and third quarter 2005, respectively. The fourth quarter 2005 survey was the fifth consecutive quarter with results above 80, which means that 8 out of 10 businesses surveyed feel positive about the economic environment.

Before 2003, survey results above 80 would last only several quarters before dropping. As the survey has remained above 80 for the past 15 months, respondents perceive better economic fundamental changes may last. The index showed a dip in three out of the five surveyed sectors: new vehicle sales, building contractors and retailers. The wholesaler index rose by 6 points while manufacturing confidence remained steady, possibly reflecting that producers had adjusted to the rand's strength. Source: Reuters, November 28.

¶9. Comment. Most analysts expect that the South African Reserve Bank (SARB) will not change interest rates at the December meeting. October inflation still shows second-round oil price inflationary pressures absent and private sector credit demand has leveled to 20%, an increase high enough that would not support future reductions in interest rates. SARB Governor Mboweni and Finance Minister Manuel continue to warn about building inflation, making sure that inflationary expectations do not increase. End comment.

SA GOVERNMENT WILL PUBLISH OFFICIAL POVERTY MEASURE
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¶10. The South African government will publish an official poverty benchmark, according to Lesetja Kganyago, the Director General of National Treasury. The poverty measure would use not only income, but also access to basic services such as water, sanitation, health and

education facilities. According to the World Bank's poverty indicator, households that survive on less than $2 (about R13) a day are considered to be living in poverty. However, Kganyago said that although the World Bank measure was useful for international comparisons, South Africa needed to create its own poverty index that incorporated more than just income. Kganyago felt that it was too early to comment on the frequency or other details of the poverty survey, but confirmed that Statistics SA would publish it. A bid related to the development of the official poverty measure would be advertised within the next few weeks. The poverty benchmark is developed at the same time the government was starting a new national income dynamic study, which would examine the effect of government interventions on households. The study will be done early in 2006 and a pilot project will be carried out in the second half of 2006. Source: Business Report, November 28.

MUTUAL FUNDS TO OFFER ACCOUNTS TO LOW-INCOME MARKET
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¶11. The South African mutual funds (unit trust) industry is planning on offering savings accounts aimed at the lower income market, similar to the banking sector's Mzansi accounts. According to Di Turpin, the Chief Executive of the Association of Collective Investments, a proposal submitted to the government for the industry as a whole creates and markets a single mutual fund as an additional way to save. Provisionally called Fundisa, meaning "learning" in Nguni languages, the fund would attract lower fees than normal mutual funds and invest only in fixed interest-bearing assets to reduce capital loss risks. This recent announcement brings the mutual fund industry in line with the Financial Sector Charter, requiring signatories to provide low income market with access to affordable products. The life insurance industry has indicated that it will provide lower-income products early in 2006. The South African mutual fund industry, manages assets worth more than R450 billion ($69 billion, using 6.5 rands per dollar). Source: Business Day, November 29.

RECENT RESEARCH SHOWS POVERTY HAS FALLEN IN PAST FOUR YEARS
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¶12. Poverty has decreased since 2000 because of the expansion of government grants and accelerated job creation, according to Servaas van der Berg and Megan Louw, researchers at the University of Stellenbosch. The research paper mapped poverty trends in South Africa from 1993 to 2004. Using household income data from the annual or semi-annual All Media and Product Surveys (AMPS)

collected by the South Africa Advertising Research Foundation with national account household income data and setting the poverty line at an annual R3,000 ($460, using 6.5 rands per dollar, or $1.26 per day) per capita, the authors found that poverty has declined more rapidly since ¶2000. The proportion of the population living below the poverty line rose slightly from 40.6% to 41.3% between 1993 and 2000, as a result of poor economic growth and labor market prospects, but then declined to 33.2% by ¶2004. This brings the total number of poor people down to 15.4 million in 2004 from 16.2 million in 1993. The average per capita income of an individual belonging to the poorest 20 percent of the population has risen from R855 ($130) to R1,185 ($182) between 1993 and 2004 (all monetary values are given in 2000 rand terms). Van der Berg and Louw attributed the large reduction in poverty levels since 2000 to expansion in social welfare grants and faster economic growth, but argued that sustainable poverty reduction cannot depend on grants alone, needing a large-scale expansion in jobs. The research also showed

that the black middle class has been growing very rapidly. The number of black people who are members of households earning more than R40,000 ($6,150) per person a year has increased threefold in the past decade. Source: Business Report, November 29.

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